1977 ANNUAL REPORT

File

AMERICAN EAGLE PETROLEUMS LTD.

AMERICAN EAGLE PETROLEUMS LTD.
(Incorporated under the laws of Saskatchewan)

Officers and Directors and Their Principal Occupations

Dallas E. Hawkins II, Calgary, Alberta
Chairman of the Board of Directors & Director
President of Oakwood Petroleums Ltd.,
Oil and Gas Company.

Gerhard Kasdorf, Calgary, Alberta
President & Director
Vice-President of Oakwood Petroleums Ltd.

Brian G. McCombe, Calgary, Alberta
Secretary and Director
Partner with McCombe, Cameron & Cormie,
Barristers & Solicitors

Brian S. Ekstrom, Calgary, Alberta
Treasurer
Vice-President of Oakwood Petroleums Ltd.
President of Brian Ekstrom Management Ltd.,
Management Company.

Neil G. Cameron, Calgary, Alberta
Director
Partner with McCombe, Cameron & Cormie
Barristers and Solicitors

Gerald E. Naylen, Regina, Saskatchewan
Director
Partner with Hleck, Kanuka & Co.,
Barristers and Solicitors

Trudy V. Kerr, Calgary, Alberta
Assistant Secretary

Head Office
2700 Shell Centre, 400 - 4th Avenue S.W.
Calgary, Alberta T2P 0J4

Subsidiary Companies
American Eagle Petroleums, Inc.
Gull Oil & Gas Ltd.

Auditors
Thorne Riddell & Co., Calgary, Alberta

Legal Counsel
McCombe, Cameron & Cormie

Banker
The Royal Bank of Canada, Calgary, Alberta

Registrars and Transfer Agent
The Canada Trust Company, Calgary, Alberta
Montreal, Toronto, Regina

Stock Exchange Listing
Toronto Stock Exchange

Statistical Summary

	1977	1976
Crude Oil and Natural Gas Sales	**$1,023,680**	$ 520,936
Net Earnings (Loss)	**(132,951)**	(317,826)
Earnings (Loss) per share	**(.03)**	(.08)
Shares Outstanding	**4,471,309**	4,151,629
Gross Wells Drilled		
Oil	**24**	10
Gas	**8**	15
Dry	**7**	11
Net Reserves		
Oil — Proved and Probable (barrels)	**661,300**	560,400
Gas — Proved and Probable (million cubic feet)	**16,328**	16,478
Producing & Non-Producing Property Interests		
Gross Acres	**1,661,236**	1,985,257
Net Acres	**109,784**	117,836
Number of Shareholders	**1,204**	880

Directors' Report to Shareholders

The Directors of American Eagle Petroleums Ltd. are pleased to present your Company's Annual Report for the year ended December 31, 1977.

During 1977 your Company's gross revenue increased approximately 94%, to a new high of $1,026,478. This resulted in a net profit before depreciation, depletion and income taxes of $122,602. The Company was again very active in drilling and participated in 39 gross wells, of which 24 were oil wells, 8 were gas wells and 7 were dry holes.

In September the Alberta Energy Minister announced that a significant D-2 discovery had been made in West Pembina and is of major importance to the oil industry in Western Canada. Since the original well was drilled a number of additional discoveries have been made. Your Company is well represented in the West Pembina Area, having an interest in approximately ten and a half sections. Chevron has taken a farm-in on the acreage and recently drilled a well to determine the potential of the D-2 Horizon. Unfortunately this well was dry and abandoned.

During 1977 your Company also commenced negotiations with certain interests in Germany to establish a Drilling Fund in the amount of three million dollars. Negotiations are continuing and we anticipate that this money will be available to us for new ventures later in the year. In anticipation of this, your Company has taken an option from Oakwood Petroleums Ltd. to participate in a drilling venture in East Texas. To date, two wells have been drilled in the East Texas Prospect, both having been completed as gas wells, and a third well is presently drilling.

Because of the natural gas over-supply problem now existing in our industry, your Company has been focussing its attention on developing oil reserves. In line with this policy, American Eagle participated in the drilling of 2 oil wells in the Grand Forks area and 21 oil wells in the Vermilion area during 1977. It is anticipated that further drilling will be necessary in both of these areas during 1978 to more fully develop the potential of both areas.

In order to increase its working capital and to fund its development programs, American Eagle entered into an agreement with Oakwood Petroleums Ltd. in late 1977, whereby Oakwood purchased 200,000 shares of treasury stock at a price of $2.89 per share. Oakwood Petroleums Ltd. also holds an option to purchase an additional 200,000 treasury shares at $3.40 per share. This option expires November 23, 1978.

We would once again like to thank the staff for their efforts and the shareholders for their continued interest in the Company.

On behalf of the Board of Directors

G. Kasdorf

G. Kasdorf
President

May 19, 1978

Areas of Operations in Western Canada

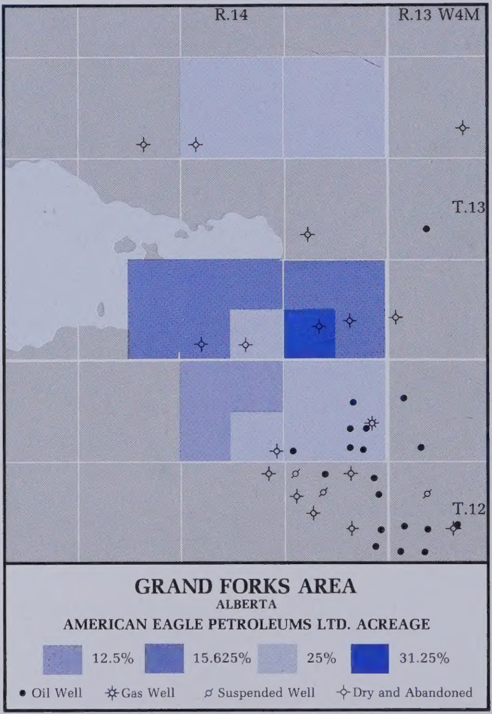
Reserves

Your Company has once again engaged independent engineering firms to evaluate its oil and gas property holdings. Effective January 1, 1978, these engineering reports indicated that American Eagle had net proven and probable recoverable oil reserves totaling 661,300 barrels. At the same time net proven and probable natural gas reserves totaled 16.3 billion cubic feet. Based on these current engineering evaluations, the Company's producing properties are estimated to produce future net revenue having a present worth of approximately $13.8 million, utilizing a 12% discount factor.

It is to be noted that these current reserve figures do not give full impact to the development program carried on in late 1977 by your Company in the Grand Forks and Vermilion areas of Alberta. Once these wells have been fully completed and put on production, it is anticipated that these two areas alone will have a significant positive impact on your Company's proven oil reserves.

Development Drilling and Exploration

Grand Forks Area, Alberta (see Map)



The Company has varying working interests ranging from 12.5% to 31.25% in 4,160 acres of Petroleum and Natural Gas leases located in the Grand Forks area of southeastern Alberta. Five producing oil wells are located on these lands. In September 1977, the Company and its partners drilled a significant oil discovery that proved to be an extension to the Grand Forks Upper Mannville "B" pool. Since that time four additional wells have been drilled of which three have been completed as oil wells and are currently producing. The fourth well was cased and waiting completion. The oil trend appears to continue through our acreage and additional wells are being planned as soon as drilling rigs become available.

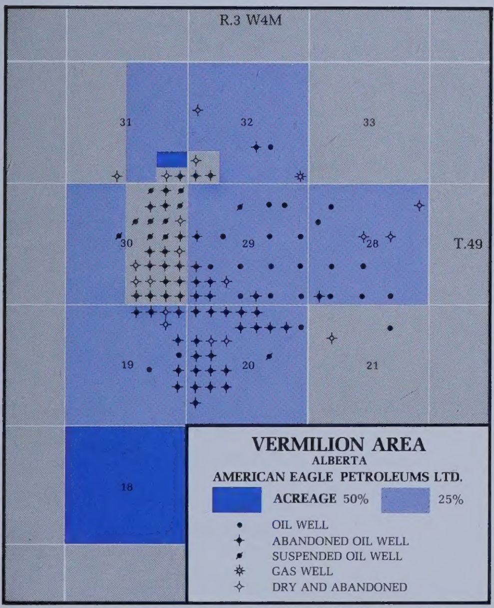
The Company and its partners will commence a pressure maintenance scheme as soon as possible in order to achieve maximum recovery from this pool. We expect to produce an average of 200 barrels of oil per day from these wells. American Eagle Petroleums Ltd. has a 25% working interest to payout, reducing to 18.75% after payout in each well. Based on an average net pay of 20 feet, the recoverable oil reserves are estimated at 600,000 barrels per 40 acres. Depending on future drilling results, this development could result in a major asset to the Company.

Vermilion Area, Alberta

Your Company and partners have a working interest of 25% and 50% in approximately 5,100 acres in the Vermilion area. Part of this area was originally developed twenty years ago and was abandoned prior to increased oil prices. Your Company and partners have drilled 34 oil wells in this pool during 1977 and early 1978. Production in the pool comes from the Sparky Sands which have a pay thickness ranging from 5 - 10 feet. The gravity of the crude is approximately 15° API and therefore this reservoir is classified as a heavy oil pool. By drilling these wells, we have developed approximately 1,564,000 barrels assuming no secondary recovery. Production from the wells averages approximately 30 barrels per day.

Your Company and partners are presently investigating the secondary recovery potential of this pool and based on preliminary investigations, it is anticipated that we can increase the recoverable reserves to 2,800,000 barrels by water flooding. Your Company and partners will be actively

engaged in instigating a viable secondary recovery scheme in this pool during 1978. In addition, we will also be drilling more wells to delineate the areal extent of the pool. This area represents a significant part of American Eagle's oil reserves and continued effort will be extended to fully develop its potential.



Financial Highlights

1977 was a most significant year in your Company's growth as evidenced by the almost 100% increase in revenue from oil and gas sales. For the first time in the Company's history, oil and gas sales net of all royalty burden, exceeded the one million dollar mark — totaling $1,023,680, as compared to approximately $521,000 in 1976. Even more significant is the fact that cash flow generated from operations was approximately $200,000 for 1977, whereas 1976 operations experienced a negative cash flow of approximately $184,000. As the Company's properties presently under development come onto production, we can anticipate further significant growth in both revenues and cash flow from operations in the coming fiscal year.

In the summer of 1977, the Company issued a one million dollar subordinated debenture. This additional working capital combined with increased working capital through additional production bank loans, has provided much needed working capital to finance the Company's development activities presently under way. The working capital position of the Company was further strengthened by the issuance of 200,000 shares of treasury stock to Oakwood Petroleums Ltd. in late 1977, net proceeds to the Company being $578,000.

The shares of the Company are listed on the Toronto Stock Exchange. The stock was one of the most actively traded oil and gas stocks on that exchange during 1977 with more than 9.7 million shares being traded. The price range of the stock during the past two years is as follows:

	1977		1976	
Quarter	**High**	**Low**	High	Low
First	**$.58**	**$.38**	$.49	$.34
Second	**.42**	**.36**	.70	.36
Third	**1.79**	**.46**	.57	.355
Fourth	**4.55**	**1.25**	.49	.375

Consolidated Balance Sheet

December 31, 1977 and 1976

ASSETS

	1977	1976
CURRENT ASSETS		
Cash and term deposits	**$ 617,194**	$ 16,328
Accounts receivable	**580,761**	813,097
Receivable from related companies	**56,473**	115,801
	1,254,428	945,226
RECEIVABLE UNDER SHARE PURCHASE PLAN — (note 4)	**50,000**	—
INVESTMENT IN E.P.C. CORPORATION, at cost less amounts written off	**21,442**	21,442
PROPERTY AND EQUIPMENT (note 2)		
Producing petroleum and natural gas leases and rights including development and equipment thereon, at cost	**4,846,085**	4,135,102
Accumulated depletion and depreciation	**1,504,755**	1,237,553
	3,341,330	2,897,549
Non-producing properties, at cost	**445,851**	340,198
	3,787,181	3,237,747
DEFERRED FINANCE CHARGES, at cost less amortization (note 3)	**43,771**	—
	$5,156,822	$4,204,415

Approved by the Board

Dallas E. Hawkins III Director

G. Kaadorf Director

LIABILITIES

	1977	1976
CURRENT LIABILITIES		
Bank indebtedness, secured (note 3)	**$ —**	$ 344,691
Accounts payable and accrued liabilities	**598,290**	1,226,536
Payable to related companies	**188,201**	—
Current maturities on long-term debt	**131,333**	60,000
	917,824	1,631,227
LONG-TERM DEBT (note 3)	**2,432,748**	1,327,186
DEFERRED INCOME TAXES	**443,779**	408,100

SHAREHOLDERS' EQUITY

	1977	1976
CAPITAL STOCK (note 4)		
Authorized		
20,000,000 common shares without par value		
Issued		
4,471,309 shares (1976 — 4,151,629 shares)	**3,760,730**	3,103,210
DEFICIT	**(2,398,259)**	(2,265,308)
	1,362,471	837,902
	$5,156,822	$4,204,415

Consolidated Statement of Earnings

YEARS ENDED DECEMBER 31, 1977 AND 1976

	1977	1976
REVENUE		
Sale of oil and gas	$ 1,023,680	$ 520,936
Interest and other	2,798	9,400
	1,026,478	530,336
EXPENSES		
Field operating	278,924	162,670
Lease rentals on non-producing properties	47,476	43,160
Exploration	31,242	163,515
Engineering and consulting	37,051	53,506
General and administrative	329,238	199,882
Interest and expense on long-term debt	179,945	127,882
Depreciation and depletion	267,202	176,439
	1,171,078	927,054
Loss before income taxes	(144,600)	(396,718)
Income taxes (recovery)		
Provincial royalty tax credits	(47,328)	(36,292)
Deferred	35,679	(42,600)
	(11,649)	(78,892)
LOSS	$ (132,951)	$ (317,826)
LOSS PER SHARE, based on weighted average number of shares outstanding during the year	$ (0.03)	$ (0.08)

Consolidated Statement of Deficit

YEARS ENDED DECEMBER 31, 1977 AND 1976

	1977	1976
DEFICIT AT BEGINNING OF YEAR	$(2,265,308)	$(1,947,482)
Loss	(132,951)	(317,826)
DEFICIT AT END OF YEAR	$(2,398,259)	$(2,265,308)

Consolidated Statement of Changes in Financial Position

YEARS ENDED DECEMBER 31, 1977 AND 1976

	1977	1976
WORKING CAPITAL DERIVED FROM		
Operations	$ 197,794	$ —
Issue of capital stock	657,520	—
Issue of subordinated debenture	1,000,000	—
Prepayments under gas sales contracts	—	147,186
Production bank loan	220,000	40,000
	2,075,314	187,186
WORKING CAPITAL APPLIED TO		
Operations	—	183,987
Additions to property and equipment	841,925	905,017
Current maturities on long-term debt	114,438	—
Advances to E.P.C. Corporation	—	21,441
Deferred finance charges	46,346	—
Receivable under share purchase plan	50,000	—
	1,052,709	1,110,445
INCREASE (DECREASE) IN WORKING CAPITAL POSITION	1,022,605	(923,259)
WORKING CAPITAL (DEFICIENCY) AT BEGINNING OF YEAR	(686,001)	237,258
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	$ 336,604	$ (686,001)
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in current assets		
Cash and term deposits	$ 600,866	$ (390,241)
Accounts receivable	(232,336)	348,677
Receivable from related companies	(59,328)	64,491
	309,202	22,927
Decrease (increase) in current liabilities		
Bank indebtedness	344,691	(344,691)
Accounts payable and accrued liabilities	628,246	(694,888)
Payable to related companies	(188,201)	126,500
Current maturities on long-term debt	(71,333)	(33,107)
	713,403	(946,186)
INCREASE (DECREASE) IN WORKING CAPITAL POSITION	$1,022,605	$ (923,259)

Notes to Consolidated Financial Statements
YEARS ENDED DECEMBER 31, 1977 AND 1976

1. ACCOUNTING POLICIES

(a) Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries all of which are wholly-owned.

(b) Property and Equipment

The Company follows the practice of capitalizing the acquisition costs of both producing and non-producing properties and charging costs to earnings if the property is subsequently surrendered. The cost of drilling a productive well is capitalized and the cost of a non-productive well is charged to earnings when the well is determined to be dry. The costs of producing leases and development thereon are amortized using the unit-of-production method based upon estimated quantities of oil and gas as determined by the Company's engineers.

Equipment is depreciated on a straight-line basis over its estimated useful life at rates varying from 5 to 20 per cent per year.

(c) Income Taxes

The Company follows the tax allocation method of accounting whereby the income tax provision is based on the earnings reported in the financial statements. Accordingly, full provision has been made for income taxes deferred as a result of claiming for tax purposes capital cost allowances and exploration and development costs in excess of the related depreciation and depletion reflected in the financial statements.

2. PROPERTY AND EQUIPMENT

1977	Cost	Accumulated Depletion and Depreciation	Net
Producing petroleum and natural gas rights including development thereon	$3,652,935	$1,151,036	$2,501,899
Production equipment	1,170,174	339,131	831,043
Office equipment and improvements	22,976	14,588	8,388
	4,846,085	1,504,755	3,341,330
Non-producing petroleum and natural gas rights including development thereon	395,450	—	395,450
Non-producing mining properties	50,401	—	50,401
	445,851	—	445,851
	$5,291,936	$1,504,755	$3,787,181

1976	Cost	Accumulated Depletion and Depreciation	Net
Producing petroleum and natural gas rights including development thereon	$3,254,562	$ 962,793	$2,291,769
Production equipment	857,814	262,413	595,401
Office equipment and improvements	22,726	12,347	10,379
	4,135,102	1,237,553	2,897,549
Non-producing petroleum and natural gas rights including development thereon	265,881	—	265,881
Non-producing mining properties	74,317	—	74,317
	340,198	—	340,198
	$4,475,300	$1,237,553	$3,237,747

3. LONG-TERM DEBT

	1977	1976
Production bank loans	**$1,400,000**	$1,180,000
Prepayments under gas sales contracts	**164,081**	207,186
Subordinated debenture	**1,000,000**	—
	2,564,081	1,387,186
Less current maturities	**131,333**	60,000
	$2,432,748	$1,327,186

The bank indebtedness included in current liabilities and the production bank loans are evidenced by demand promissory notes and are secured by specified petroleum and natural gas properties and a first floating charge debenture on all other assets of the Company. The production loans are repayable out of future production proceeds and, accordingly, are not expected to require the use of working capital; therefore, no portion of such loans has been reclassified to current liabilities. Interest is payable at the rate of 1½% above the prime rate set from time to time by a Canadian chartered bank.

The subordinated debenture is secured by a second floating charge on all assets of the Company. The debenture is repayable over five years by monthly instalments commencing August 1978. Interest is payable at the bank prime rate plus 1% (minimum 9% — maximum 12% per year). In addition the debenture holder is to receive a fixed royalty from certain gas properties of $2,500 per month from September 1977 to August 1983, and $1,250 per month from September 1983 to August 1987. Financing charges of $46,346 related to the issuance of the debenture have been deferred and are being amortized on a straight-line basis over the term of the debenture.

The estimated principal payments on long-term debt for the next five years are as follows: 1978 — $404,683; 1979 — $540,000; 1980 — $536,000; 1981 — $480,000; 1982 — $480,000.

4. CAPITAL STOCK

No common shares were issued in 1976. In 1977 shares were issued as follows:

	Shares	Cash Consideration
Pursuant to share purchase plan	100,000	$ 50,000
Pursuant to exercise of share purchase warrants	19,680	29,520
Pursuant to an agreement with Oakwood Petroleums Ltd., which owns 45.4% of the issued capital stock of the company	200,000	578,000
	319,680	$657,520

Under the terms of a share purchase plan 100,000 shares were issued to an officer of the Company. The aggregate purchase price of $50,000 is payable prior to August 31, 1984, and is secured by the issued shares which are held in trust pending payment. Shares which remain unpaid as at August 31, 1984, are to be returned to the Company in full settlement for any amounts then owing.

Common shares have been reserved:

	Number of Shares	
	1977	1976
For issuance to Oakwood Petroleums Ltd. at $3.40 per share pursuant to an option expiring November 23, 1978	200,000	—
For issuance on exercise of share purchase warrants at $1.50 per share expiring October 22, 1981	280,320	300,000
For issuance to agents of an investors group at $2.10 per share pursuant to an agreement whereby an investors group is to spend between $1,000,000 and $3,000,000 for petroleum exploration on properties in which the Company will retain a net profit interest. The option to acquire shares is earned pro rata after the expenditure of a minimum of $1,000,000. The option expires in October 1982.	300,000	—
Pursuant to a share purchase plan whereby a director may acquire shares at $0.50 each	—	100,000
	780,320	400,000

5. STATUTORY INFORMATION

During 1977 the Company and its subsidiaries paid $1,300 to the Company's five directors in their capacity as directors and paid $77,320 (1976 — $44,876) to officers of the Company, who are also directors.

Auditors' Report

To the Shareholders of
American Eagle Petroleums Ltd.

We have examined the consolidated balance sheet of American Eagle Petroleums Ltd. as at December 31, 1977 and 1976 and the consolidated statements of earnings, deficit and changes in financial position for the years then ended and have obtained all the information and explanations we have required. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, and according to the best of our information and the explanations given to us and as shown by the books of the company, these consolidated financial statements are properly drawn up so as to exhibit a true and correct view of the state of affairs of the company as at December 31, 1977 and 1976 and the results of its operations and the changes in its financial position for each of the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

In accordance with the requirements of the Saskatchewan Companies Act we report that, in our opinion, all the transactions of the company that have come within our notice have been within the objects and powers of the company.

Calgary, Alberta
March 17, 1978

Thorne Riddell & Co.
Chartered Accountants

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